

Memo

To: Employees assigned city owned vehicles
From: Catherine Fanello, City Controller
CC: Department Heads; Matt Chlebowski, Director of Central Services; Cheryl Lips, City Internal Auditor; John Murphy, Assistant City Controller
Date: 3/27/08 (presented on March 31, 2008 to drivers of take home vehicles); (presented on April 10, 2008 to department fiscal staff persons)
Re: Take Home Vehicle – Required Fringe Benefit Tax Reporting -IRS Compliance

This memo is intended to provide guidance to employees who have been assigned a city vehicle. The IRS code regarding employee fringe benefits is complex and you should consult your personal tax advisor if you have questions related to your tax return. We will make every effort to address any city procedural questions you may have. **All employees assigned a city-owned vehicle will be required to sign a form describing the valuation method that will be used by the city during 2008.**

Background

Federal law requires that the City of South Bend include in an employee's income the amount of benefit the employee receives from an employer provided vehicle. This adjustment to the employee's income is made on the annual W-2. The adjustment is known as a taxable fringe benefit and is subject to federal and state income tax withholding and FICA and Medicare taxes.

In years prior to 2007, the City of South Bend used the IRS method called the Commuting Value to adjust the annual W-2 for the vehicle benefit for all employees. This rule states that employees are charged \$1.50 *per trip* for commuting to or from work. The city, therefore, charged \$3.00 per day for a round trip commute. It has come to our attention that this method is not acceptable for all city provided vehicles.

For the year end 2007 all assigned vehicles were valued using the Annual Lease Value method. This method calculates an annual W-2 adjustment based on the fair market value of the vehicle the day it was first made available to the employee. Once the fair market value is established it must be used for four (4) years. The fair market value of the vehicle may be revalued at the beginning of the fifth (5th) year.

Vehicles were **not** revalued from the original fair market value on date of purchase for the 2007 W-2 adjustment. Some have asked whether 2007 W-2's can be revised to reflect a revaluation. Unfortunately, the W-2's can not be adjusted from our original submission. The IRS has cautioned that we not adjust what was done for 2007. They are of the position that some employees received a tax benefit in past years because they were not charged the full fair market value for personal use. **As we go forward, the fair market values will be appropriately revalued in the fifth year to reflect the decrease in value over a four-year time period.**

Since the city provides fuel, we must **also** include a value for fuel in the annual W-2 adjustment. This value is 5.5 cents for every personal mile driven by the employee. Employees were instructed in September 2007 to begin keeping detailed mileage logs to substantiate business and personal miles and should have continued to turn in mileage logs each month as instructed. A copy of the original memo requesting such action is attached.



CITY OF SOUTH BEND GUIDE TO VALUATION OF PERSONAL USE OF CITY PROVIDED VEHICLES

I. GENERAL RULE

The personal use of a city-owned vehicle is a **taxable fringe benefit** to the employee. Personal use includes commuting to or from work and any use that is not work related. Each employee who is assigned a vehicle will sign a statement each year acknowledging the valuation method to be used by the City of South Bend to adjust the employee's annual W-2. Employees will also acknowledge they understand their record keeping responsibility under the IRS regulations regarding their assigned city-owned vehicle. All questions regarding this guide should be directed to the City Controller.

II. REPORTING TAXABLE FRINGE BENEFITS

Under each method, taxable fringe benefits must be reported on form W-2. This amount is reported and taxed as "Social Security Wages" and "Medicare Wages." On the form W-2, the taxable fringe benefit must be included in boxes 1, 5, and possibly 3. The value must also be reported in box 14.

Social Security and Medicare taxes will be withheld, as required by law, but the City elects not to withhold federal or state income tax under either method. Federal and State income taxes are the employee's responsibility. Any employee who wishes to withhold additional federal or state income tax throughout the year in order to avoid underpaying on your annual tax return may do so by filling out a new federal W-4 form or a state WH-1. Please see Human Resources for further information.

III. ANNUAL ADJUSTMENT METHOD

The City will use one of two methods to value an employee's annual W-2 adjustment for personal use of a city-owned vehicle; Annual Lease value or Commute Value. The valuation method used will be made available in written format to each employee by January 31st each year for the current year. Each employee's valuation method will be determined based on the position held by the employee and the purpose of the city provided vehicle.

Annual Lease Value

Generally, this method will be applied to any employee who is allowed to use a city-owned vehicle for other than commuting to work. This method must be used for elected officials. The following steps are followed under this method:

- a. Establish the vehicle fair market value on the date it is first made available to the employee for personal use. This usually is the purchase price paid by the city and includes any applicable tax or title fees to acquire the vehicle. Once the fair market value is established, the following table determines the Annual Lease Value (ALV) that must be used to adjust the employee's annual W-2. See 2008 table below.

Annual Lease Value Table

(This table is subject to change by the IRS)

<i>Automobile fair market value</i>	<i>Annual Lease Value</i>
\$0 to 999	\$ 600
1,000 to 1,999	850
2,000 to 2,999	1,100
3,000 to 3,999	1,350
4,000 to 4,999	1,600
5,000 to 5,999	1,850
6,000 to 6,999	2,100
7,000 to 7,999	2,350
8,000 to 8,999	2,600
9,000 to 9,999	2,850
10,000 to 10,999	3,100
11,000 to 11,999	3,350
12,000 to 12,999	3,600
13,000 to 13,999	3,850
14,000 to 14,999	4,100
15,000 to 15,999	4,350
16,000 to 16,999	4,600
17,000 to 17,999	4,850
18,000 to 18,999	5,100
19,000 to 19,999	5,350
20,000 to 20,999	5,600
21,000 to 21,999	5,850
22,000 to 22,999	6,100
23,000 to 23,999	6,350
24,000 to 24,999	6,600
25,000 to 25,999	6,850
26,000 to 27,999	7,250
28,000 to 29,999	7,750
30,000 to 31,999	8,250
32,000 to 33,999	8,750
34,000 to 35,999	9,250
36,000 to 37,999	9,750
38,000 to 39,999	10,250
40,000 to 41,999	10,750
42,000 to 43,999	11,250
44,000 to 45,999	11,750
46,000 to 47,999	12,250
48,000 to 49,999	12,750
50,000 to 51,999	13,250
52,000 to 53,999	13,750
54,000 to 55,999	14,250
56,000 to 57,999	14,750
58,000 to 59,999	15,250

For vehicles having a fair market value in excess of \$59,999, the annual lease value is equal to: (.25 x the fair market value of the car) + \$500.

- b. The ALV remains in effect for four (4) years. At the beginning of the fifth year, the value may be recalculated. If a vehicle is transferred to another employee, the value may be recalculated as long as the original intention was not to avoid taxes on the fringe benefit. To recalculate the fair market value, nationally recognized publications that regularly report new and used retail values will be consulted. Documentation will be kept by Central Services regarding the recalculation of values and the publication consulted.

- c. Based on the monthly mileage logs submitted by the employee, the difference between business and personal miles will be calculated. The employee's annual W-2 will be adjusted by the Annual Lease Value less the business miles driven.

Example: Fair Market Value equals \$30,000. Therefore, ALV equals \$8,250. Total miles driven for the year equals 10,000 and personal miles driven equals 2,000.

$$1. \text{ Fraction of business miles to total miles} = \frac{10,000 - 2,000}{10,000} = \frac{8,000}{10,000} = 80\% \text{ business}$$

$$2. 80\% \text{ business} \times \$8,250 = \$6,600 \text{ (business miles substantiated)}$$

$$3. \text{ Employee personal portion added to W-2} = \$8,250 - \$6,600 = \$1,650$$

- d. Because the city also provides its own fuel, a value of the fuel benefit received must also be added to the employee's annual W-2. The personal portion of fuel is calculated at 5.5 cents per mile (per IRS).

Example: Using the same information from above.

$$2,000 \text{ personal miles driven} \times 5.5 \text{ cents} = \$110$$

$$\text{Total amount added to employee annual W-2} = \$1,650 + \$110 = \$1,760$$

- e. If the employee does not drive the assigned vehicle for the entire year, the annual W-2 adjustment must be prorated by multiplying the Annual Lease Value by the number of days of availability to 365 total days.
- f. If the vehicle is assigned to an employee for less than 30 days, a computation of the daily lease value must be made. The daily lease value is calculated by multiplying the Annual Lease Value by four times the number of days of availability to 365 total days.

COMMUTE VALUE

Some departments have established that certain vehicles may not be used for personal use other than commuting to or from work. For those employees who meet the following criteria, their annual W-2 will be adjusted by the taxable benefit of **\$1.50 per commuting trip**.

- The vehicle is used for city business only;
- The city requires the employee to commute to or from work in the vehicle;
- The city has a written policy prohibiting personal use other than commuting and certain minimal personal purposes, and the employee isn't allowed to drive the vehicle for any other reason; and
- The employee using the vehicle is not a (1) elected official or (2) an appointed employee whose compensation exceeds \$139,600.

These employees are required to maintain a log showing the number of daily commutes, the mileage for each commute, and the total number of vehicle miles. The IRS must be satisfied that the vehicle is used for city business. This is substantiated by showing that the total miles for commuting is less than 50 percent of the miles the vehicle is in use during each annual tax reporting period.

The employee will be required to sign an annual statement that attests the vehicle has not been driven for any personal use other than commuting or a *de minimis* personal use (such as stopping for lunch or an occasional personal errand between business runs).

Shared Vehicles (inserted 4/09/08)

Some departments have vehicles that are shared among employees. The IRS has specific rules on shared vehicles and these situations must be reviewed by the City Controller and the City Internal Auditor so that proper IRS rules may be applied to the particular shared vehicle circumstances and relevant facts.

Accounting Period

In order to ensure that timely adjustments are made to the employee's annual W-2, the city has elected to value the taxable fringe benefit from November 1st to October 31st. For example, the adjustment made to 2008 W-2's will be based on mileage logs submitted from November 1, 2007 to October 31st, 2008. Recalculation of vehicle fair market values will be made on November 1st of the fifth year the vehicle was made available to the employee.

IV. REQUIRED RECORD KEEPING

If you are allowed to use your city-owned vehicle for personal use, daily mileage logs **must be** maintained by the employee. The required mileage log may be found on the city employee web site or by contacting Central Services. Mileage logs must document the time, date, place, purpose, and odometer readings of the vehicle.

A **copy** of the mileage log must be turned in monthly to Central Services by the fifth (5th) working day of each month documenting the previous month's information. Central Services also requires a monthly summary of total miles and business miles used to be completed by each department with assigned city-owned vehicles. This summary may be found on the city employee website or by contacting Central Services.

Copies of handwritten mileage logs are acceptable as long as they are legible. Electronic copies are preferred. In either instance, the employee must sign and date the mileage log form each month. Electronic signatures are acceptable. Each employee is responsible for maintaining their original mileage log. Central Services will keep their copy on file for a period of four (4) years. The monthly summary prepared by the department must be submitted electronically and will also be kept on file for a period of four (4) years.

Failure to maintain adequate and/or legible mileage logs will result in a 100% Annual Lease Value adjustment to the annual W-2. Once again, the IRS believes it is the employee's responsibility to substantiate **business** use of the vehicle. Any difference between total mileage and substantiated business mileage is deemed personal use and is taxable to the employee. Where business miles are not substantiated, all miles are deemed personal and the benefit is 100% taxable to the employee under the Annual Lease Value method rules.

An employee who prefers to avoid the record keeping requirement will incur a 100% adjustment for the annual lease value of the vehicle plus a value for city provided fuel. The Department of Administration and Finance must be notified by January 31st each year for the current year if the employee elects to not keep mileage records and have 100% of the use of the vehicle considered taxable.

V. EXCEPTION TO RECORD KEEPING REQUIREMENTS

Parked Vehicles (added 4/9/08)

City-owned vehicles used only for city business and kept on city property, when not in use, are exempt from record keeping and taxation. **All such vehicles must be identified in the vehicle inventory as parked vehicles (4/9/08). The final determination of whether or not a vehicle meets this exception will be determined by the City Controller and the City Internal Auditor (revised 4/09/08).**

Qualified Non-Personal Use Vehicles (revised 4/9/08)

Qualified non-personal use vehicles are any vehicle that the employee is not likely to use more than minimally for personal purposes because of the design of the vehicle. **Determination of whether a vehicle meets this exception will be determined by the City Controller, City Internal Auditor and with the assistance of Central Services.**

The following vehicles, due to their very nature, are exempt from record keeping and taxation as well:

- Clearly marked police and fire vehicles **meeting certain IRS requirements**;
- Unmarked law enforcement vehicles when used for authorized purposes and operated by a full-time certified law enforcement officer;
- Delivery trucks with a seat for only one driver or only the driver and a folding jump seat;
- Flatbed trucks;
- Cargo carriers with more than 14,000 pounds gross vehicle weight;
- Ambulances;
- Bucket trucks;
- Forklifts;
- Concrete Mixers;
- Dump trucks;
- Garbage trucks;
- Specialized utility-repair vehicles;
- Tractors; and
- Certain pickup trucks and vans of not more than 14,000 gross vehicle weight. Pickup trucks and vans must be clearly marked with permanently affixed decals, special painting, or other advertising.

Pickup trucks **have** to be equipped with one of the following;

- a hydraulic lift tailgate;
- permanently installed tanks or drums;
- permanently installed sideboards or panels raising the sides of the truck bed; or
- permanently installed heavy equipment such as a welder, electric generator, boom, or crane.

Vans must have a seat for only the driver and possibly a jump seat for one other person. Vans must also have either permanent shelving installed or an open cargo area in the van used solely to carry material or equipment for city purposes, i.e. public works maintenance and repair, utility maintenance and repair. **Pickup trucks without the options listed above are not exempt and personal use will be taxable.**